



THE TAXPAYER CHOICE ACT

Q&A

What's so wrong about the AMT?

- The Alternative Minimum Tax (AMT) was designed in 1969 as a mandatory add-on to the existing tax code. It was aimed at preventing 155 wealthy taxpayers from exploiting loopholes in the tax code to escape legitimate tax obligations. But because it was never indexed for inflation, the AMT next year will subject close to 30 million more taxpayers to an automatic tax increase.
- Most of these folks are far from rich. Under current tax law, for instance, in tax year 2007, about 70 percent of married taxpayers with children earning \$75,000 to \$100,000 will be subject to AMT. Over the next 10 years, the AMT's scope will impose \$841 billion in higher taxes, mostly on middle-income families. Under the AMT law, these millions of taxpayers will be required to calculate their taxes two ways – under the existing code, and under the AMT – and then *pay the higher tax*. This is clearly an illegitimate tax that should be repealed without penalizing taxpayers.

Why is the RSC proposing an AMT bill at this time?

- Ways & Means Committee Chairman Charlie Rangel (D-NY) has announced that his committee will soon consider an AMT reform bill. The effort to reform the AMT will be one of the most significant tax-related bills that Congress moves this year. Though text of the Democrat bill is not yet available, the Democrat AMT proposal will replace the AMT tax hike with other tax increases – in effect “taxing Peter to pay Paul.”
- Conservatives believe that this vast expansion of the AMT, and its \$841-billion tax hike, are illegitimate – and taxpayers should not be penalized for Congress' mistake. No portion of the AMT should be left on the books. Therefore, the RSC has proposed the Taxpayer Choice Act.

This plan eliminates the AMT but doesn't pay for the \$841 billion in lost revenue. Won't this vastly increase the budget deficit at a time when everyone agrees we need to balance the budget?

- Partly because it was never indexed for inflation, the AMT is on path to ensnare millions of Americans (many of them middle income) with a stealth tax increase that was never intended. Democrats and Republicans alike are committed to seeing that this unintended, and unfair, tax increase does not happen.

- “Paying for” AMT repeal with \$841 billion of new tax increases simply replaces one wrong with another. For instance, raising top marginal rates to target “the rich” would harm the numerous small, unincorporated businesses that pay taxes under the individual income tax. These businesses are the engines of job creation in our economy.
- The real problem is excessive government spending. Congress should focus on controlling spending and reforming our unsustainable entitlement programs – not on raising taxes to “pay for” an illegitimate and unintentional tax hike.

If this tax system eliminates such popular tax preferences as the Earned Income Tax Credit (EITC), the child tax credit, and the home mortgage interest deduction, won’t that mean a huge tax increase for middle- and lower-income people?

- To be clear, the Taxpayer Choice Act does not eliminate *anything* in the current tax code. We are simply offering individuals the choice of a new simplified tax system: one with a broad tax base (i.e. no tax preferences), two low tax rates and a generous exemption amount. Many taxpayers will find that their overall taxes are lower and simpler under the new system.
- This new system has a generous exemption (nearly \$40,000 for a family of four) so many low and moderate income individuals will actually pay no taxes.
- But if they choose, individuals can remain in the current tax system and can therefore take advantage of the EITC, the home mortgage interest deduction, or any other element of the current tax code.

Why can’t people simply choose between the two tax systems each year? You are calling it the Taxpayer Choice Act but there doesn’t seem to be much of a choice here.

- Allowing taxpayers a choice each year would invite “gaming” – i.e. moving between the two tax systems to avoid legitimate tax liabilities.
- The bill’s election system is fair and retains the spirit of a choice. Individuals have a full 10 years to get their financial affairs in order before choosing the new tax system. After the initial choice is made, individuals are granted one additional changeover if they feel they have made an unwise choice. Also, individuals can change tax systems if a major life event like death, divorce, or marriage alters their filing status.

Isn’t this new tax system simply designed to benefit the wealthy? After all, you have reduced the top marginal rate from 35 percent to 25 percent and made the lower rate on capital gains and dividends permanent.

- This new tax system is roughly similar to the current system in terms of progressivity. In other words, higher income earners continue to pay the majority of taxes.

- This new system has a generous exemption (nearly \$40,000 for a family of four), so many low and moderate income individuals will actually pay no taxes.
- This new tax system is simple, fair, and efficient. It cleans up the tangled web of credits and deductions, insuring that people with similar income end up paying similar amounts of taxes (horizontal equity).
- Most Americans (even ones with moderate incomes) spend hundreds of dollars complying with the current tax code – tax professionals, tax software, etc. This simplified tax system would reduce, or even eliminate, these costs

Won't adding a new tax system create an administrative nightmare? How will the IRS deal with two individual income tax systems and keep track of who should be paying under which system?

- The plan completely eliminates the individual AMT, which will go a long way toward solving one administrative headache in the current system.
- This is a first step at fundamental tax reform – the hope is that, eventually, the majority of people will end up choosing the simplified tax system.
- The simplified tax system would have much lower compliance costs for the individual and lower administrative costs for the revenue service than the current system.

Why would people choose the new tax system over the current one when it doesn't include any preferences such as the home mortgage deduction?

- As noted above, the Taxpayer Choice Act does not eliminate *anything* in the current tax code. It offers individuals the choice of a new simplified tax system. Many taxpayers will find that their overall taxes are lower and simpler under the new system – even without the complex set of preferences in the current code.
- Compliance costs for the current individual income tax are roughly \$90 billion a year. The average individual now spends 26 hours a year on his or her federal income taxes. Many individuals pay hundreds of dollars on tax professionals, filing fees and software in order to compute their tax bill. The new simplified tax system would greatly reduce, or even eliminate, these costs.
- The simplified tax system has generous exemption amounts – nearly \$40,000 for a family of four. This generous exemption goes a long way toward making up for the lack of credits and deductions in this system. And, the simplified tax system has just two low income tax rates.

Has anyone tried to get rid of the AMT before?

- In 1999, the Republican Congress sent legislation to President Clinton fully repealing the AMT, but he vetoed that bill. This is the same President that pushed (and signed into law) an AMT rate increase in 1993.

Lots of Members of Congress have AMT-repeal bills. How is yours different?

- The RSC’s bill goes an important step farther than the other AMT-repeal bills. Our bill creates a voluntary Simplified Tax that would give individuals (not corporations) the option of paying either this tax or the regular income tax as it is structured now, beginning in tax-year 2007.

Why not simply repeal the AMT? Why do you want to create a new optional and simpler tax?

- House conservatives believe that the AMT is not the only problem with the tax code. Even if we fixed the AMT, the code would remain tremendously burdensome and complicated. We believe the American people should receive the sort of reform that both repeals the AMT and ensures nothing like it will ever impact taxpayers again.

Why would you give taxpayers a choice like this?

- House conservatives believe on principle that American taxpayers not only deserve relief from future tax increases, but also deserve a choice in the way they calculate their taxes. There are already enough mandates in the federal tax code; the least we can do is offer the taxpayer some flexibility and freedom.

What about the capital gains and dividends rates?

- The capital gains and dividends tax rates would permanently remain the same as they are in current law (5%--soon to be 0%--up to a certain formulaic amount; 15% in excess of such amount).

So, your bill doesn’t raise taxes at all?

- Unlike the reported Democrat proposal, the RSC proposal would not raise taxes on anyone and would not engage in class warfare. The RSC proposal would not ask small businesses and more well-off Americans to take a financial hit in order to “pay for” tax relief for others.

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